

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

Midwest Independent Transmission System Operator, Inc.))	Docket No. ER02-1963-000
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**NOTICE OF INTERVENTION AND PROTEST
OF THE
MICHIGAN PUBLIC SERVICE COMMISSION**

Pursuant to Rules 211 and 214 (a)(2) of the Federal Energy Regulatory Commission's Rules of Practice and Procedure, 18 C.F.R. §§ 385.211, 385.214(a)(2), the State of Michigan and Michigan Public Service Commission ("Michigan") files its notice of intervention and protest in the above-captioned proceeding. In support thereof, Michigan states as follows:

I. Communications

1. Service of all pleadings, documents, and communications in this matter shall be made at the following address:

Jennifer M. Granholm Attorney General David A. Voges (P25143) Steven D. Hughey Patricia S. Barone (P29560) Assistant Attorneys General Michigan Public Service Commission Public Service Division 6545 Mercantile Way, Suite 15 Lansing, MI 48911-5984	David D' Alessandro Harvey L. Reiter Adrienne E. Clair Special Assistant Attorneys General Stinson Morrison Hecker, LLP 1150 18 th Street, NW Suite 800 Washington, DC 20036-3816
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II. Basis for Intervention

2. The Michigan Public Service Commission ("MPSC") is an agency of the State of Michigan, created by 1939 P.A. 3, Mich. Compiled Laws 460.1 *et seq.*, as the Michigan regulatory agency having jurisdiction and authority to control and regulate rates, charges, and

conditions of service for the retail sale of electricity in the State. The MPSC intervenes in this matter pursuant to the authority conferred by applicable state statutes, rules, and procedures.

3. By the instant filing, the Midwest Independent System Operator, Inc. (“Midwest ISO”) seeks approval of changes to Attachment O of the Midwest ISO’s Open Access Transmission Tariff (“OATT”). Attachment O contains the formula rate template for the Midwest ISO. The Midwest ISO states in its filing that the changes requested are necessary to accommodate the International Transmission Company (“International Transmission”) in the Attachment O rate formula.

4. International Transmission provides transmission service in the State of Michigan. Michigan is vitally interested in matters involving the provision of electrical service to its citizens located within its borders and the rates to be charged Michigan utilities and their customers. Michigan thus has a direct interest in this proceeding that cannot be adequately represented by any other party. Therefore, Michigan’s participation and intervention is in the public interest.

III. Protest

5. In this proceeding, Michigan’s protest does not challenge the formula in Attachment O, inasmuch as that formula has already been approved by the Commission. However, Michigan does protest the inclusion of amounts in the Attachment O formula that will produce unjust and unreasonable rates. Specifically, Michigan protests the use of a 100 percent common equity ratio in Attachment O for International Transmission’s capital structure. *See* Exhibit 1, page 4, line 29.

6. As discussed herein, a capital structure with 100 percent common equity is contrary to well-established Commission policy. There are no facts in dispute requiring a hearing. Under circumstances, as here, where a filing is in clear violation of Commission policy,

the Commission should summarily reject the instant filing and direct the Midwest ISO to re-file the Attachment O rate calculation for International Transmission to include a reasonable capital structure.

7. The Commission's general policy is to use the company's actual capital structure. However, the Commission has long recognized that in instances where the actual capital structure is an aberration and its use would lead to an unreasonable return, a hypothetical capital structure should be used. In determining whether a capital structure is an aberration, the Commission looks to the range of capital structures of companies included in the proxy group from which the return on equity is derived. Thus, if the utility's equity ratio is beyond the range of equity ratios in the proxy group, the Commission will not use the actual capital structure. Instead, the Commission policy is to use a hypothetical capital structure derived from the average capital structure of the proxy group. *See Northwest Pipeline Corporation*, 87 FERC ¶ 61,266 at 62,056 (stating that the Commission's preference is to use actual capital structure unless the company's capital structure is not representative of the company's risk profile or where use of actual capital structure would lead to an anomalous result), citing *Kentucky West Virginia Gas Co.*, 2 FERC ¶ 61,139 at 61,235-28 (1978); *Transcontinental Gas Corp.*, Opinion No. 414-A, 84 FERC ¶ 61,084 at 41,413 (1998).

8. There is no basis in this record to depart from the Commission's policy regarding use of hypothetical capital structure to avoid anomalous results. International Transmission has provided no such evidence in support of its 100 percent equity ratio. In fact, there is no such evidence. To the contrary, based on reports by both Standard & Poor's and Fitch IBCA, transmission companies could have a median total debt to capitalization ratio of 55 percent to maintain an "A" bond rating. Given these reports, there is no reasonable basis for International Transmission to carry 100 percent common equity, and Michigan ratepayers should not be forced

to pay for International Transmission's unreasonable decision to rely solely on common equity in its capital structure.

9. In a proceeding regarding Transcontinental Gas Pipeline Corporation, the Commission explained the need to protect ratepayers against excessive equity in capital structure:

[t]he determination of an appropriate capital structure involves a balancing of the investor and consumer interests. Equity generally costs more than debt. Hence, ratepayers would be subjected to an excessive burden if their rates had to be set at a level high enough to compensate the pipeline for excessive equity in its capital structure. This burden on ratepayers can be limited by 'levering a capital structure with lower-cost debt.'

Transcontinental Gas Pipe Line Corporation, 71 FERC ¶ 61,305 (1995)(citations omitted). In this case, the 13 percent return on equity requested by International Transmission is derived from a proxy group of nine electric utility companies with wholly-owned affiliates that are members of the Midwest ISO. *See Midwest Independent System Operator, Inc.*, Docket No. ER02-485-000, 99 FERC ¶ 63, 011 (April 25, 2002). The capital structures of the proxy group ranged from a low of 43.5 percent equity to 58 percent debt, to a high of 61.5 percent equity to 33 percent debt. *See* Docket No. ER02-485-000, Exhibit No. S-5. Obviously, a 100 percent equity ratio far exceeds the highest equity ratio of any member of the proxy group.

10. The use of 100 percent common equity in this proceeding will have a dramatic effect on rates. For example, the use of 100 percent common equity for International Transmission in the Attachment O calculation, assuming a 13 percent return on equity in the ongoing proceeding regarding the Midwest ISO (Docket No. ER02-485-000), results in a pre-tax rate of return of **21.19 percent**. By comparison, the use of a hypothetical capital structure with 55 percent debt and 45 percent equity, with the same 13 percent return on equity and a hypothetical cost of debt of 7.5 percent produces a pre-tax return of 13.62 percent, a full 7 ½ percent lower than the pre-tax return resulting from a 100 percent equity ratio. The resulting differential 7 ½

percent, applied to the rate base in this proceeding, produces a cost impact of approximately \$25 million. This illustrates that the 100 percent equity ratio is unjust and unreasonable on its face. In any event, such a high rate of return should not be automatically accepted and put into place simply through the Attachment O mechanism. Instead, the Commission should reject the amounts included in the Attachment O mechanism where, as here, the amounts will lead to unjust and unreasonable rates.

WHEREFORE, the Michigan Public Service Commission respectfully requests that the Commission (1) grant the requested intervention and (2) reject the Midwest ISO's filing in this proceeding, for the reasons discussed above.

Respectfully submitted,

MICHIGAN PUBLIC SERVICE COMMISSION

David D'Alessandro
Harvey L. Reiter
Adrienne E. Clair
Special Assistant Attorneys General
Stinson Morrison & Hecker L.L.P.
1150 18th Street, N.W., Suite 800
Washington, DC 20036

Dated: June 21, 2002

Its Attorneys

CERTIFICATE OF SERVICE

I hereby certify that I this day served a copy of the foregoing document by first class United States mail, postage prepaid, to all parties listed on the official service list compiled by the Secretary in this proceeding.

Adrienne E. Clair